

O 092213Z FEB 09
FM AMEMBASSY CANBERRA
TO SECSTATE WASHDC IMMEDIATE 0969
INFO AMEMBASSY BEIJING
AMEMBASSY TOKYO
AMEMBASSY JAKARTA
AMEMBASSY SEOUL
AMEMBASSY SINGAPORE
AMEMBASSY OTTAWA
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY WELLINGTON
AMCONSUL MELBOURNE
AMCONSUL PERTH
AMCONSUL SYDNEY
AMCONSUL HONG KONG
AMCONSUL SHANGHAI
USEU BRUSSELS
THE WHITE HOUSE WASHINGTON DC
DEPT OF TREASURY WASHINGTON DC

C O N F I D E N T I A L CANBERRA 000135

DEPARTMENT FOR EAP, EAP/ANP, E, EEB, AND EEB/OMA
DEPARTMENT PLEASE PASS USDA FOR WAINIO
TREASURY FOR CHRISTOPHER WINSHIP
NSC FOR LOI

E.O. 12958: DECL: 02/09/2019

TAGS: EFIN ECON AS

SUBJECT: RESERVE BANK GOVERNOR DISCUSSES ECONOMY

REF: A. CANBERRA 116
1B. 2008 CANBERRA 1036

Classified By: Charge Daniel Clune for reasons 1.4 (b/d).

¶1. (C) Summary: Reserve Bank of Australia Governor Glenn Stevens told Charge that Australia will face a difficult 2009 as the result of an unprecedented worldwide loss of confidence by consumers and businesses. The RBA and the Australian Government are taking aggressive measures to stimulate the slowing domestic economy, according to Stevens, who said PM Rudd's A\$42 billion (USD 26 billion) stimulus plan (ref A) is about right in terms of size in the face of a very fast and steep fall in global demand. The RBA's rapid interest rate cuts (a full 4.0% since September) have also helped maintain demand, as did the Government's A\$10.7 billion in cash payments in December, of which Stevens believes half was spent. The RBA Governor said that Australia's financial system remains in good shape and that the four major banks have already met most of their off-shore financing requirements for 2009. He said that the downturn would drive up unemployment and cut 2009 growth to 0.5%, while the end of the commodity boom would cause a significant unwinding in Australia's terms of trade and a noticeable fall in real incomes. Despite these challenges, Stevens stressed Australia's continuing scope for further action based on the RBA's room for further interest rate cuts and what he expects will be the strong demand for Australian Government debt as the Government moves into deficit spending. He cautioned that regardless of what Australia does, the near-term state of its economy will depend on the depth of the downturns in China and the United States. End Summary

Australia's Economic Ride About to Get Rougher

¶2. (C) Charge and Econcouns met in Sydney February 6 with Glenn Stevens, Governor of the Reserve Bank of Australia. Stephens was joined by Kate Ford, his Economics Assistant. Stephens said that the global financial system appears to be stabilizing since the &unprecedented8 period between September 15 and October 15, 2008. He said that he was surprised at the speed with which emerging market countries had been affected by the global financial crisis and at the

massive fall in global demand. In particular, Stephens cited the near-collapse of Chinese growth as a surprise, saying that it probably was close to negative in the fourth quarter of 2008. Expressing cautious optimism that the worst of the financial crisis may be over, with the return of credit spreads to more normal levels, Stephens said that the challenge for 2009 would be how countries manage the economic impact of unprecedented falls in global demand.

¶3. (C) Australia has been in the comparatively lucky position of being spared the first wave of damage due to the relative strength of its financial system and the earlier impact of the resources boom. Unemployment remains at the historically low level of 4.5%, though Stephens expect this to climb sharply in the coming months. This ability to observe the impact of the crisis in other countries has allowed Australian policy-makers to try to head off the worst by prompt action, though Stevens allowed that it is impossible to know if this will be enough to prevent a very serious recession.

¶4. (C) The coming 12-18 months will be difficult for economic policy-makers around the world, Stephens said. He emphasized that Australia remains in comparatively good position for the following reasons:

-- The RBA's 3.25% interest rate leaves room for further cuts;

-- The Government entered the crisis with a net asset position and a large budget surplus, leaving it in comparatively good position to take further action after committing close to 5% of GDP to stimulate demand over two years;

-- The financial system remains healthy and has access to global capital markets.

All could change depending on the depth of the crisis, but whatever happens in Australia is likely to be less severe than in many other developed countries.

Stimulus Debate

¶5. (C) The RBA has moved quickly to use monetary policy to stimulate the economy through five consecutive interest rate cuts totaling 400 basis points since September, with the most recent being a 100 basis point cut to 3.25% on February 3. Stephens said this has delivered significant relief to consumers but has had little impact on business confidence. (nb: the vast majority of Australian mortgages are have variable interest rates that reset the next month after a change in the official interest rate. end nb.) The Government's A\$10.7 billion stimulus package announced in October 2008 (ref b) appears to have also helped, with Stephens, highlighting the December increase in retail sales (3.7% higher than December 2007) as well as the steady unemployment rate. He estimated that about half of the amount of direct payments to lower and middle-income Australian families with children and to retirees appears to have been spent (which would equate to about 0.5% of GDP). The Government's second stimulus package worth A\$42 billion announced by PM Rudd on February 2 is about the right magnitude, Stephens commented, adding that he had hoped that the combination of this plan and the RBA's 100 basis point interest rate cut the next day would create a "wow factor" that might help restore confidence.

¶6. (C) Noting the debate in Australia over the need for deficit spending to fund the package given the fall in tax revenue, Stephens said that the projection that net debt will reach 20% of GDP in the next five years does not concern him very much. Markets had historically shown considerable appetite for Australian Government debt and that this would be a manageable amount in the short to medium term. Slower longer-term global economic growth would raise more

questions, as this might signal a structural reduction in the Government's tax revenues that might lead markets to reexamine their appetite for Australian securities. The real question is the quality of the measures -- do they include investments that will lift longer-term productive capacity. Asked about the possible impact of significant Government debt issuance on the Australian dollar, Stephens doubted that there would be much of an effect in the short term.

Governments as a whole continue to be able to borrow cheaply, and while the amount of government debt on issue globally is down while the amount of government debt on issue globally is increasing rapidly, Australia has a good reputation on international markets. Also, Australian interest rates remain higher than in other developed countries.

Current Account Deficit and the Banks

¶ 17. (C) Though Australia's comparatively large current account deficit (CAD) is frequently raised by the IMF as a potential problem, Stephens expressed confidence that it remains manageable in the near term. The CAD will probably not increase much despite the fall in export earnings because slower domestic demand will reduce demand for imports.

Australia's CAD is largely funded by the country's four major banks, but Stephens said that obtaining funding this has not been a problem. After U.S. banks, Australia's four major banks have been the most active on global credit markets and have successfully raised between \$50-60 billion in offshore term funding in the past several months. Their ability to do this has been strengthened by the Australian Government's guarantee, which has brought down their borrowing costs. Stephens said that this amount represents almost all of their funding requirements for 2009, meaning that Australia is largely insulated from potential danger from its CAD for the rest of the year.

It's All About China and the United States

¶ 18. (C) While 2009 will be difficult for Australia regardless of what happens around the world, developments in the United States and China will play the greatest role in shaping Australia's economic future. The speed and degree to which both countries return to growth will determine the extent of the downturn and shape the prospects for a return to growth for Australia. Stephens expressed hope that the United States and China will strengthen cooperation on economic issues, saying that this would both support growth as well as increase confidence.

Clune